When regulation is expropriation

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Supervisor: Prof. Jan Klabbers
by Jenny Santikko
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HELSINGIN YLIOPISTO
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This thesis aims to answer the question of when regulatory measures taken with regard to environmental concerns amount to expropriation. International investment treaties provide protection against both direct and indirect expropriation and initially cover also indirect takings caused by regulatory measures. Two opposite doctrines, the sole effects doctrine and the police powers doctrine, have evolved to answer the very question of when regulatory measures amount to expropriation. In this thesis I will execute a doctrinal study in order to argue that while the police powers doctrine might be more politically legitimate, it does not find sufficient legal support from the sources of international law, and therefore, the sole effects doctrine finding firm legal support from the investment treaties should prevail.

The sole effects doctrine determines the existence of regulatory expropriation by examining the effect that the regulatory measure has on the investment. This doctrine finds its legal support from the investment treaties. It is supported by the wordings and terms used in the expropriation clauses. When interpreting the investment treaties according to the rules of treaty interpretation laid down in the Article 31 of the Vienna Convention on Law of Treaties, it is rather evident that the sole effects doctrine should prevail. The police powers doctrine on the other hand states that measures falling into the police powers of the state fall out of the scope of indirect expropriation. According to the police powers doctrine non-discriminatory regulatory measures that are taken in the public interest and enacted with due process shall not be deemed expropriatory and compensable. The police powers doctrine does not find any support from the investment treaties and the expropriation clauses initially cover general regulatory measures. Thus the police powers doctrine relies on its alleged support from the customary international law.

In order to determine if the police powers doctrine is legally sustainable, I will first analyse the rulings of the investment tribunals, and observe how the tribunals have answered the question of regulatory expropriation. In the case law analysis, I will conclude that tribunals tend to determine indirect expropriation by referring to the effect of the measure. Correspondingly, the initial examination of the existence of an indirect expropriation is executed by examining the effect that the government measure has on the investment. As to the question of the weight given to the public interest concerns, no unified opinion is to be found. Some of the tribunals do endorse the police powers doctrine but no unified practice seems to exist also on this regard. The placement and way of endorsement of the police powers doctrine in the practice suggest that the police powers doctrine is a possible exception doctrine. The treaty clauses regarding expropriation do not include exceptions of any kind, and therefore, in order to support the police powers doctrine this exception needs to be found from the customary international law. Since a profound examination of the existence of a customary international law norm would require extensive research, in this thesis will concentrate on pointing out factors that indicate that such norm odes not exists.

After concluding that the police powers doctrine does not find sufficient legal support from the investment treaties or from the customary international law, I will discuss the argument that the police powers doctrine often uses to justify itself and that is the need for balancing the interests. I will also discuss shortly about the transplantation of the proportionality analysis into the investment treaty sphere and conclude that neither of these gives support to the endorsement of the police powers doctrine. At the end of the thesis I can conclude that since the police powers doctrine does not find sufficient legal support, the sole effects doctrine should prevail.

Avainsanat – Nyckelord – Keywords
International investment law, investment protection, expropriation, indirect expropriation, regulatory expropriation, the sole effects doctrine, the police powers doctrine, environmental regulation

Ohjaaja tai ohjaajat – Handledare – Supervisor or supervisors
Prof. Jan Klabbers

Säilytyspaikka – Förvaringställe – Where deposited

Muita tietoja – Övriga uppgifter – Additional information

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Abbreviations

Association of Southeast Asian Nations - ASEAN

Bilateral Investment Treaty - BIT

Comprehensive Economic and Trade Agreement (EU - Canada) - CETA

Energy Charter Treaty - ECT

European Court of Human Rights - ECHR

European Court of Justice - ECJ

International Centre for Settlement of Investment Disputes - ICSID

International Law Commission - ILC

International Court of Justice - ICJ

North American Free Trade Agreement - NAFTA

Vienna Convention on the Law of Treaties - VCLT

1. Introduction

1.1. A short introduction to the thesis

The question of when regulatory measures may amount to expropriation has taunted arbitrators and legal scholars for several decades.[1] Foreign investors are protected by a web of international investment treaties in which the states have promised to protect the investors against both direct and indirect expropriations. The concept of indirect expropriation has had a long history of controversy. The controversy culminates in the tension found between the promised standard of protection and the legitimate regulatory interests of the host state. Expropriation clauses do not exclude regulatory measures per se from the scope of indirect expropriations,[2] and therefore, the promised standard of protection initially includes protection against indirect expropriation caused by regulatory measures. States have been reluctant to agree that regulatory measures taken in the public interest could be deemed expropriatory, and the state would be obligated to compensate the negatively affected investor. To protect their regulatory freedom, states have appealed to their police powers recognized under the customary international law.[3]

The tension between investment protection and states' regulatory interests is especially high regarding measures that are connected to environmental concerns. In the past few decades, the seriousness of the increasing amount of environmental issues has been acknowledged at a global level. It is widely agreed that more stricter action needs to be taken and fast. States are facing increased pressure to take regulative action in order to protect and preserve the environment. It is both legally and politically challenging to answer the tense question of when regulatory acts connected to environmental concerns should be deemed expropriatory, and the state obliged to compensate the investor for the negative effects of the regulatory act.

Two opposite doctrines, the sole effects doctrine and the police powers doctrine, are seeking an answer for the question of when regulatory measures amount to expropriation. The sole effects doctrine defines the line between normal regulatory measures and regulatory measures amounting to expropriation through the depriving effect that the measure has on

[1] Gazzini (2010), p. 50 and Zamir (2017), p. 320
[2] Tecnicas Medioambientales Tecmed S.A. v. United Mexican States, Award, para. 121
[3] Nikièma (2012), p. 3 and Zamir (2017), p. 320

the investment. This doctrine draws the line between normal regulation and expropriation, by solely examining the effect that the government measure has on the investment. The police powers doctrine on the other hand does not agree that the effect should be the only factor considered, and therefore, emphasizes especially the meaning of a legitimate public purpose behind the regulatory measure when determining whether the state act is to be deemed expropriatory. Neither of the two doctrines is currently prevailing, and it is hard to predict which approach an investment tribunal will choose when confronted with the issue of regulatory expropriation.[4]

The aim of this thesis is to answer the question of when regulatory measures amount to expropriation. This thesis will conclude that the appropriate way of determining the line when regulation amounts to expropriation is, by following the sole effects doctrine. I will execute a doctrinal study in order to argue that while the police powers doctrine might be more politically legitimate in the current climate, especially when the regulatory measure is connected to environmental concerns, it does not have sufficient legal support, and therefore, the sole effects doctrine finding firm legal support from the investment treaties shall prevail.

1.2. Limitations and remarks

1.2.1. Fragmentation of the treaty base

A special feature of the international investment law is that it consists of large number of bilateral investment treaties[5] and of a few multilateral treaties containing investment protection provisions.[6] Because of the wide fragmentation of the treaty base, one must always keep in mind that each expropriation clause must be applied and interpreted in its own context and terms. Therefore, this thesis cannot give a certain one fits all answer. This does not, however, diminish the point of the general level examination that this thesis provides. It has been widely recognized among the scholars and in the arbitration practice

[4] Schill (2010), p. 110
[5] Day of the writing (1.9.2019) there are 2354 bilateral investment treaties into force according to United Nations Conference on Trade and Development (UNCTAD) https://investmentpolicy.unctad.org/international-investment-agreements
[6] When referring to 'investment treaties' in this thesis, i will count in both bilateral investment treaties and multilateral treaties that not only concentrate on investment protection but contain a body of investment protection provisions such as NAFTA and CETA.

that the content of the expropriation clauses, and in general of investment treaties, is strikingly similar. It is also common in the investment arbitration practice that investment tribunals will refer to the rulings of other investment tribunals that have been faced with a similar clause but in a different investment treaty.[7]

1.2.2. Concentration on the 'representative' expropriation clauses

This thesis will concentrate on answering the question of when regulatory measures amount to expropriation regarding expropriation clauses that follow the prevalent model of expropriation clauses.[8] As will be discussed in chapter nine, a new generation of expropriation clauses is evolving. The newer expropriation clauses are still rather rare, and the importance of the discussion of how the 'older' but still far more prevalent expropriation clauses should be applied cannot be overlooked. Finland, for example, has over 60 bilateral investment treaties in force today.[9] The newest BITs were signed in 2009. These treaties signed in 2009 still do not represent the new generation.[10] This would suggests that despite the fact that a newer generation of expropriation clauses is evolving the 'older' expropriation clauses remain prevalent.

1.2.3. Concentration on the investment treaties

This thesis will focus on the investment treaty sphere. Investment contracts concluded between a host state and a foreign investor regarding a specific investment are not discussed. If such contract has been concluded between an investor and a host state, this agreement might contain additional clauses regarding expropriation. This thesis will solely concentrate on the scope of protection provided by the investment treaties concluded between two or more states. This thesis will also not be discussing the question of how to determine the

[7] Dolzer & Schreuer (2012), p. 286
[8] More on the wordings of the prevalent expropriation clauses in chapter 3.4.1.
[9] https://investmentpolicy.unctad.org/international-investment-agreements/countries/71/finland (day of the writing 1.9.2019)
[10] See Finland - Hong Kong, China SAR BIT (2009), Finland - Panama BIT (2009), and Finland - Nepal BIT (2009)

scope of indirect expropriation solely based on the norms of customary international law in a situation where there is no applicable investment treaty.

1.2.4. Concentration on the cases with environmental connection

Another important limitation is that this thesis will concentrate on the question of indirect expropriation in cases where the allegedly expropriatory act is connected to the public interest of protecting the environment. In other words, this thesis will concentrate on environmental regulatory expropriation. The focus on indirect expropriation cases that are connected to environmental concerns feels appropriate. The problem between environmental concerns and indirect expropriation is extremely timely and relevant. The need for effective action and stricter regulation regarding environmental matters has been acknowledged at a global level. States are facing increased pressure to take strict regulative action and have also shown to be readier than ever to enact new stricter regulations.[11] On the other hand the desire to attract foreign investment has remained high, and the tension between the conflicting interests seems to be at an all time high.

[11] See for example the 'Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the reduction of the impact of certain plastic products on the environment' (2018/0172 (COD))

2. Investor and Investment

2.1. Introducing the terms

In order to discuss more profoundly of the scope of protection that the expropriation clauses in the investment treaties provide, it is appropriate to shed some light into two intertwined terms: 'investor' and 'investment'. These terms directly define the scope of protection, by determining who and what is protected. Expropriation clauses in the investment treaties protect foreign investors from direct and indirect expropriation of their investments.

2.2. Investor

The term investor determines who is protected from the expropriatory acts of a host state. All investment treaties provide their own definitions for the term investor. Generally two types of investors are recognized, natural persons and legal persons. Even though the international investment law is designed primarily to protect the activities of private investors, also government-controlled entities can be protected as long as they act in a commercial capacity. Whether non-profit organizations are protected as investors will depend on the nature of the activity concerned and of the definition that the specific treaty has adopted.[12] Some investment treaties explicitly state that only investors operating in a commercial capacity will be protected while some treaties extent the protection to all legal persons "whether or not organized in pecuniary gain".[13] Unincorporated entities or groupings on the other hand are not generally protected as investors unless otherwise provided by a treaty.[14]

Regarding the term investor, the main focus has not been in the determination of the actual term investor, but in the determination of the nationality of the investor. The question of nationality is a key interest in two regards. First, if an investor wants to rely on the protection provided by a bilateral or regional investment treaty, it must show that it has the nationality of one of the treaty parties. Second, if the investor wants to seek protection

[12] Dolzer & Schreuer (2012), p. 44
[13] Argentina - Germany BIT (1991) Article 1(4)
[14] Dolzer & Schreuer (2012), p. 47

through the ICSID Convention, it must show that it has the nationality of one of the ICSID member states. Therefore, the applicability of the material standards as well as the jurisdiction of an international tribunal are determined by the nationality of the investor.[15] It is also important to note that consequently the nationals of the host state are generally excluded from the protection that the investment treaties provide.[16]

The nationality of a natural person is determined primarily according to the municipal legislation of the relevant state.[17] A certificate of nationality granted by the state concerned is to be considered as strong evidence, but not always as a conclusive proof of nationality. In the case of dual nationality, tribunals have seen the doctrine of a genuine link, developed in the diplomatic protection context, inapplicable. The possibility of having two effective nationalities has been recognised in the practice.[18] Some treaties like the ECT explicitly extend the protection not only to nationals, but also to permanent residents.[19]

Determination of the nationality of a legal person is more problematic, but rather important considering that investors are in the majority of the cases corporations. National legal systems and investment treaties have adopted various ways of determining the nationality of corporations and other legal persons. Investment treaties can even adopt different definitions regarding how each contracting party will determine the nationality of legal persons. One of the two most used criteria is incorporation.[20] The place of incorporation refers to the nationality of the state in which and under which laws the entity is incorporated. For example the ECT follows the incorporation criterion, and provides in the Article 1(7)(a)(ii) that an entity shall be "organized in accordance with the law applicable in that Contracting Party". The second of the two most used criteria is the place of the main seat of the business ('siége social').[21] According to this criterion, a corporation has the nationality of the state where its effective management is situated. The two criteria, incorporation and the siége social, are sometimes also combined. For example, according to the ASEAN Comprehensive Investment Agreement Article 1(2) a company shall be "incorporated or constituted under the laws in force in the territory of any contracting party wherein the place of effective management is situated". Some treaties go even further than these rather formal

[15] Dolzer & Schreuer (2012), p. 44-45
[16] Dolzer & Schreuer (2012), p. 46, and ICSID Article 25(2)(a) "does not include any person who on either date also had the nationality of the Contracting State party to the dispute…"
[17] Wisner (2004), p. 928
[18] Dolzer & Schreuer (2012), p. 46
[19] ECT article 1(7)(a)(i)
[20] Dolzer & Schreuer (2012), p. 47
[21] Dolzer & Schreuer (2012), p. 47

requirements of incorporation and siége social, by providing that there needs to be a genuine economic bond between the corporation and the state concerned. This would mean that an effective control of the entity by the nationals of the state, or alternatively a genuine economic activity in the state territory needs to be established.[22] These methods have partly been used to counteract unwanted treaty shopping.[23] Another way that states have responded to treaty shopping is, by including a 'denial of benefits' clause in their treaties. A denial of benefits clause denies the benefits of the treaty to an entity incorporated in the state, but that has no real economic connection to the state.[24]

Since host states may sometimes require that an investment shall be made through a locally incorporated company, some investment treaties (as well as the ICSID convention) provide that legal persons incorporated in the host state can be treated as foreign due to the foreign control.[25] Normally, without this kind of clarification, legal persons incorporated in the host state would be excluded from the treaty protection.

The position of shareholders as independent investors seeking protection under the investment treaties has provoked some discussion. International law has, however, accepted the right of the shareholders to bring claims independent of the corporation.[26] Nowadays investment treaties also often include a reference to shares, shareholding, or participation in corporations when defining what they consider as investments. This assures the position of the shareholders as investors capable of bringing independent claims against a host state. As a general rule, the size of the investment bears no relevance. The shareholder does not have to be a majority shareholder in order to be regarded as an investor. Only the fact that an investment has been made bears relevance.[27]

[22] Dolzer & Schreuer (2012), p. 49
[23] There has been already evidence of corporations starting to treaty shop. For example the big U.S. corporations, GE and Bechtel have tried to overcome the lack of BIT between India and the United States by relying on the Indian-Mauritius BIT through their Mauritian subsidiaries. Wisner (2004), p. 944
[24] Dolzer & Schreuer (2012), p. 55, and the ECT Article 17(1)
[25] Dolzer & Schreuer (2012), p.51-55
[26] Muchlinski, Ortino, & Schreuer (2008), p. 81-82
[27] Muchlinski, Ortino, & Schreuer (2008), p. 82-86

2.3. Investment

2.3.1. The broad concept of investment

Expropriation clauses in the investment treaties protect against an expropriation of an investment. An investment is the object of the protection. By determining the scope of the term investment, one determines what objects are possibly protected from the expropriatory acts of the host state. Broadening the conception of an investment, automatically broadens the notion of expropriatory action.[28] The increasing and ever changing concept of property rights brings an additional problematic to the discussion of the scope of indirect expropriation.[29]

As for the term investor, investment treaties usually provide a definition for the term investment. While the national foreign investment laws tend to lean towards transaction or enterprise-based approaches,[30] the majority of the investment treaties tend to side with more broader asset-based definitions. The asset-based definitions usually include a list of assets and investment types that are protected. Most bilateral investment treaties follow a model that contains a general phrase that defines the term investment containing broadly 'all assets' accompanied by an illustrative list of categories, while some treaties have opted for a narrower definition, by providing an exhaustive list of the types of assets that are protected as investments.[31]

Investment treaties tend to also include the legality of an investment as a part of the definitions. Bilateral investment treaties often define the investment as "in accordance with host state laws and regulations".[32] This means that only investments that are made in accordance with the national legislation of the host state may enjoy the protection that the treaty provides. It is, however, questionable if this legality requirement should be understood only as referring to the material legality of an investment, or if it also requires processual legality.[33]

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[28] AlQurashi (2004), p. 901
[29] AlQurashi (2004), p. 903 and Douglas, Pauwelyn & Viñuales (2014), p. 365-366
[30] In the transaction-based model the target of the protection is the underlining capital transfer rather than the assets of the investor. The enterprise-based model on the other hand protects the business organization of the investment. Muchlinski, Ortino, & Schreuer (2008), p. 52
[31] Muchlinski, Ortino, & Schreuer (2008), p. 57-58
[32] For example Argentina-Germany BIT Article 1(1) , Albania-Spain BIT Article 1(2) and Finland - Ukraine BIT (1992) Article 1(1)
[33] See more about the differentiation between material and processual legality of an investment: Kulick (2012), p. 332-335

A key feature of the investment treaties is that they are designed to protect foreign investments. The foreignness of the investment is determined by the nationality of the investor which has been discussed above. Therefore, the actual origin of the capital is not a decisive factor on this regard.

Some investment treaties explicitly state that only investments in the territory of the host state are protected. This statement has been understood as a requirement of certain physical presence of the investment in the territory of a host state. Investment tribunals have adopted a rather strict approach on this matter in cases of physical businesses in comparicon to cases involving for instance financial instruments.[34]

As with the term investor, the term investment is also important when determining the jurisdiction of the ICSID. The Article 25(1) of the ICSID Convention ties the jurisdiction of the Centre "to any legal dispute arising out of an investment". It is, however, been stated in the arbitration practice that the term investment in the investment treaties could possibly receive a different interpretation than what shall be given to the term when determining the jurisdiction according to the ICSID Convention.[35] Since the topic of this thesis concentrates on the material protection clauses of the investment treaties, the determination of the term investment for a jurisdictional purpose is not that necessary, and therefore, will not be discussed any further.

2.3.2. Contracts as investments

It is rather usual that big investment decisions are accompanied by specific investment contracts between an investor and a host state. In these contracts the investor and the host state can agree on more specific issues and in a further reaching manner. These contracts usually cover issues like taxation, customs regulations, and pricing issues. Also stabilization clauses are commonly included in these agreements.[36] By laying down the important legal and financial foundation for the possible investment, these contracts have a fundamental weight in the making of the business decision of investing. Because of the practical importance of these contracts, almost all modern investment treaties provide that also

[34] Dolzer & Schreuer (2012), p. 76-78
[35] Muchlinski, Ortino, & Schreuer (2008), p. 62-64
[36] More on stabilisation clauses Brabandere, & Gazzini (2012), p. 221-222

contracts are included in the term investment, and therefore, protected by the treaty standards.[37]

As investments, contracts are also protected from the expropriatory acts of a host state, and the idea, that contractual rights can be expropriated, is widely accepted by legal scholars and the arbitration practice.[38] However, it is essential to note that not every failure to perform a contract shall be considered constituting an expropriation even when the breach of the contract leads to a loss of rights under the contract. In order to distinguish between a normal breach of a contract and an expropriation, tribunals have looked into whether the state acted in an official, governmental capacity when breaching the contract. Only when a state is acting in an official capacity when breaching the contract, expropriation may be deemed to have occurred.[39]

[37] Dolzer & Schreuer (2012), p. 126-129

[38] Parkerings-Compagniet AS v. Republic of Lithuania, Award, para 440

[39] Dolzer & Schreuer (2012), p. 126-129; Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, Award, para 458: "Rather, the critical distinction is between situations in which a State acts merely as a contractual partner, and cases in which it acts "iure imperi", exercising elements of its governmental authority. These are often termed "actes de puissance publique", where the use by the State of its public prerogatives or imperium is involved in the actions complained of." and Parkerings-Compagniet AS v. Republic of Lithuania, Award, para 443: "First, a breach of an agreement will amount to an expropriation only if the State acted not only in its capacity of party to the agreement, but also in its capacity of sovereign authority, that is to say using its sovereign power."

3. Expropriation

3.1. The sovereign right to expropriate

Even though the expropriation clauses in the investment treaties are written in a prohibitive manner, they do not actually prohibit states to take expropriatory action. As a part of the notion of territorial sovereignty, the inherent right of the state to expropriate alien property on its territory has been recognized and accepted. Since the right of the state to take expropriatory action is such a fundamental right, even the modern investment treaties respect it.[40] Investment treaties, however, lay down requirements that need to be fulfilled in order for the expropriatory act to be considered lawful.[41] Even though the state's right to take regulatory action constituting expropriation is not prohibited, a state might feel that investment treaties lay down such heavy requirements for a lawful expropriation that its sovereign right to take expropriatory action is in practice affected. The risk of high compensation connected to indirect expropriations has sometimes led to question whether investment treaties can possibly cause a regulatory chill especially regarding environmental matters.[42]

3.2. Lawful expropriation

3.2.1. Criteria for lawful expropriation

As stated above international investment treaties do not prohibit direct or indirect expropriation. Instead they set requirements that shall be met in order for the expropriation to be considered lawful. According to the Article 13(1) of the ECT:

> "Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation")

[40] Dolzer & Schreuer (2012), p. 98
[41] Nikièma (2012), p. 3
[42] Freeman (2003), p. 181 and Bungenberg, Griebel, & Hindelang (2011) p. 150

except where such Expropriation is:

(a) for a purpose which is in the public interest;

(b) not discriminatory;

(c) carried out under due process of law; and

(d) accompanied by the payment of prompt, adequate and effective compensation."

Most of the modern investment treaties contain the same three (or four) requirements.[43] First of these requirements regards the public purpose. Expropriation should always serve a purpose of pubic interest in order to be lawful. The notion of public interest has a broad meaning, and it is often seen appropriate to give the states quite a bit of discretion to decide how they want to determine public interest.[44] It is, however, not unseen that an investment tribunal addresses the significance and limits of this requirement.[45] According to the second requirement, the expropriatory measure shall not be arbitrary or discriminatory. The third possible requirement provides that the expropriatory measure must follow the rules of due process. This requirement is not always counted in since it repeats the minimum standard under customary international law, and is also part of the fair and equitable treatment standard.[46] The fourth and most feared requirement is compensation. Expropriation must always be accompanied by a prompt, adequate, and effective compensation. The fair market value of the expropriated investment is nowadays understood generally as adequate.[47]

It is notable that the requirement of compensation is a so called either-or requirement. If expropriation has occurred, the investor is according to the text of the treaty entitled for full compensation (the fair market value of the investment). Correspondingly, if concluded that expropriation has not occurred, the investor is entitled to no compensation at all.

[43] López (2014) p. 117

[44] Dolzer & Schreuer (2012), p. 99 and López (2014) p. 125 and 134

[45] ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary, ICSID Case No. ARB/03/16, Award, para 429-433

[46] Dolzer & Schreuer (2012), p. 99-100

[47] According to the Article 13(1) of the ECT: "Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date")." and López (2014) p. 118

3.2.2. Unlawful expropriation

If one or more of the three (or four) requirements of lawful expropriation are not met, the expropriation is deemed unlawful. The significance of determining whether or not the expropriation is lawful lies in the standard of compensation. In the case of lawful expropriation, the investor is entitled for adequate compensation as the expropriation clauses provide. However, in the case of unlawful expropriation, the investor is entitled to reparation according to the rules of customary international law. In the case of unlawful expropriation, the investor is entitled not only to 'compensation' but to 'reparation' which includes losses, lost profits and indirect damages.[48]

3.3. Direct expropriation

In direct expropriation, the owner is deprived of his legal title of the property. Because direct expropriation requires a legal transfer of a title, it is quite unproblematic to determine whether a direct expropriation has happened. Direct expropriation can be established by examining the existence of the legal rights to the property. States have, however, become more and more reluctant to directly expropriate alien property. One reason being that they want to avoid the negative publicity that a direct taking would bring, and therefore, affect negatively the state's reputation as a venue for foreign investment.[49] Partly due to these reasons, the focus of the international investment law has shifted towards the problematic surrounding indirect expropriations.[50]

[48] Nikièma (2013), p. 2-3.The compensation standard for unlawful expropriation was expressed by the Permanent Court of International Justice in the Chorzów Factory Case (Germany/Poland), September 13, 1928 : "Reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by the restitution in kind or payment in place of it—such are the principles which should serve to determine the amount of compensation due for an act contrary to international law."
[49] Dolzer & Schreuer (2012), p. 101
[50] AlQurashi (2004), p. 897

3.4. Indirect expropriation

3.4.1. The concept of indirect expropriation

Aside with direct expropriation, most of the investment treaties provide protection against indirect expropriation.[51] In an indirect expropriation, also referred as de facto expropriation, no legal transfer of a title of the ownership takes place. In the case of indirect expropriation, the investor still remains as the legal owner of the property. The act of indirect expropriation, however, deprives the investor of the possibility of utilizing the property in a meaningful way. Indirect expropriation in general covers measures that have the effect of direct expropriation in other words an effect of total or near total deprivation of the investment.[52] Therefore, an indirect expropriation has the effect of a direct expropriation without the legal transfer of a title. The effect amounting to expropriation has been described in the practice by stating:

> "The required level of interference with rights has been variously described as "unreasonable"; "an interference that renders rights so useless that they must be deemed to have been expropriated"; "an interference that deprives the investor of fundamental rights of ownership"; "an interference that makes rights practically useless"; "an interference sufficiently restrictive to warrant a conclusion that the property has been 'taken'"; "an interference that makes any form of exploitation of the property disappear"; "an interference such that the property can no longer be put to reasonable use."[53]

Since the existence of an indirect expropriation does not flow from a legal transfer of a title or from another other easily recognisable act, states are often keen to deny the existence of an indirect expropriation in order to avoid the obligation of paying high amount of compensation.

Expropriation clauses can be divided into two main categories according to the terminology used regarding indirect expropriations. The first more common type of clauses distinguishes between direct expropriation or nationalisation and indirect expropriation or equivalent measure or measures with equivalent/similar effects. Expropriation clauses in this

[51] Nikièma (2012), p. 5
[52] Zamir (2017), p. 319
[53] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, Award, para 463

category use just one of the above mentioned expressions of indirect expropriation excluding the other two.[54] Clauses of this category use following formations:

- "measures having effect equivalent to nationalisation or expropriation"[55]
- "subjected to any other measure the effects of which would be tantamount to expropriation or nationalization"[56]
- "expropriate nationalize or take similar measures"[57]
- "nationalise, expropriate or subject to measures having effect equivalent to nationalisation or expropriation"[58]
- "shall take any measure depriving, directly or indirectly"[59]

The second type of expropriation clauses distinguishes between three types of expropriation including direct expropriation, indirect expropriation and equivalent measures/measures with similar/equivalent effects. Treaties signed by North American and Latin American countries as well as Switzerland use this kind of terminology. [60] Clauses of this category use following formations:

- "directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation"[61]
- "shall take, either directly or indirectly, measures of expropriation, nationalization or any other measures having the same nature or the same effect against investments"[62]

These type of formations have begged the question of the difference between an indirect expropriation and a measure with equivalent effects. The investment tribunals have, however, seen the two expressions "indirect expropriation" and "measures with equivalent effects" as initially covering the same concept.[63]

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[54] Nikièma (2012), p. 5
[55] For example Czech Republic - Hungary BIT (1993) Article 5(1)
[56] For example Germany - Poland BIT (1989) Article 4(2)
[57] For example China - Romania BIT (1994) Article 4
[58] For example Australia - Romania BIT (1993) Article 5(1) and similary Finland - India BIT (2002) Article 5(1)
[59] For example Norway - Chile BIT (1993) Article 6(1)
[60] Nikièma (2012), p. 6
[61] For example NAFTA Article 1110 (1)
[62] For example Kenya - Switzerland BIT (2006) Article 6(1)
[63] Nikièma (2012), p. 6 and S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Partial Award, para 286: "The Tribunal agrees with the conclusion in the Interim Award of the Pope & Talbot Arbitral Tribunal that something that is "equivalent" to something else cannot logically encompass more. In common with the Pope & Talbot Tribunal, this Tribunal considers that the drafters of the NAFTA intended the word "tantamount" to embrace the concept of so-called

3.4.2. Control and deprivation of the economic value of the investment

Control of the investment is an important factor in the determination of whether an indirect expropriation has occurred. If the investor is deprived of the control of the investment, it strongly militates that an indirect expropriation has occurred. However, the fact that the investor remains in the control of the investment is not to be seen as conclusive proof that an indirect expropriation has not happened. Even if the investor is not deprived of the control of the investment, but the government measure substantially deprives the economic value of the investment, an indirect expropriation has occurred.[64]

3.4.3. Duration of the measure

The duration of the measure and the duration of the effect of the measure affecting the interests of the investor are essential factors when determining whether an indirect expropriation has occurred.[65] Even when the government measure deprives the economic benefit of the investment, if the depriving effect is only temporary, no expropriation has occurred. Expropriation generally requires a lasting or permanent deprivation of the investment. In the case of S.D. Myers v. Canada, the tribunal concluded that:

> "An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary."[66]

Naturally, it is challenging to define a certain time period for how long the duration of the measure must last in order for it to be considered 'lasting' or 'permanent'. Application of this criterion requires a case-by-case approach, and will depend highly on the circumstances of a particular case.

"creeping expropriation", rather than to expand the internationally accepted scope of the term expropriation."

[64] Dolzer & Schreuer (2012), p. 117-118

[65] Dolzer & Schreuer (2012), p. 124

[66] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Partial Award, para 283

3.4.4. Legitimate expectations

Legitimate expectations of an investor are an important aspect of property protection, and have recently received increasing attention in the investment practice.[67] More traditionally legitimate expectations have played an essential part in the interpretation of the fair and equitable treatment standard. Legitimate expectations have, however, also entered the sphere of indirect expropriation, and investment tribunals have concluded that the disappointment of legitimate expectations can play an important part in the determination of whether an indirect expropriation has occurred.[68] The concept of legitimate expectations is rather general in nature, and it is hard to draw mechanical conclusions from it. The legal framework of the host state at the time of the investment is one important source of investor expectations.[69] For the purpose of expropriation claims, investment tribunals have held a rather high threshold regarding legitimate investor expectations. In a case where the investor is not given special assurances by the host state, or if the investor is engaged in a particularly high-risk market, expectations are seen as less legitimate. The high threshold of legitimate expectations applied in regard to expropriation claims does not, however, exclude the possibility that the same expectations may play a role when applying other investment protection standards like the requirement of fair and equitable treatment.[70]

3.4.5. Omissions constituting an indirect expropriation

It remains controversial whether indirect expropriation can result solely from omissions of a host state. Some tribunals have explicitly stated that expropriation always requires some kind of action, and therefore, omissions alone cannot constitute expropriation. Other investment tribunals have on the other hand endorsed the idea that whether or not the deprivation of the investment is due to omissions or acts makes no difference.[71] However, the circumstances in which an investor would be deprived of his investment due to omissions alone are in practice rare. The problematic of whether an omissions alone can constitute expropriation is also not that relevant in the context of this thesis considering that this thesis

[67] Dolzer & Schreuer (2012), p. 115
[68] Muchlinski, Ortino, & Schreuer (2008), p. 448-449
[69] Dolzer & Schreuer (2012), p. 115
[70] Muchlinski, Ortino, & Schreuer (2008), p. 448-449
[71] Muchlinski, Ortino, & Schreuer (2008), p. 431-432

concentrates on the problematic of indirect expropriations that are connected to regulatory measures that a state has taken with regards to environmental concerns.

3.4.6. Regulatory expropriation

An indirect expropriation, that is caused by a regulative act of a state, is at times referred to as regulatory expropriation or regulatory taking. In other words, regulatory expropriation occurs when a regulatory act of the state diminishes the value of the investment to such an extent that the act is to be deemed expropriatory. The effect of the regulatory act upon the economic benefit and the value of the investment together with the effect upon the control of the investment are also key factors when determining whether the regulatory measures shall be deemed constituting indirect expropriation.[72] As stated at the beginning of this thesis, it remains, however, controversial in both practice and in academy writings whether the effect of the regulatory measure shall be the only determinative factor, or should other factors like the purpose and the character of the regulatory act be taken into account.

3.5. Creeping expropriation

The term creeping expropriation describes a situation where an expropriation (direct or indirect) results from a cumulated series of acts and/or omissions that lead to the same end result as an expropriation resulting from a single decisive act. The idea of cumulative effect constituting an expropriation reflects the Article 15(1) of the ILC's Articles on State Responsibility.[73] According to the Article 15(1):

> "The breach of an international obligation by a State through a series of actions or omissions defined in aggregate as wrongful occurs when the action or omission occurs which, taken with the other actions or omissions, is sufficient to constitute the wrongful act."

[72] Dolzer & Schreuer (2012), p. 112
[73] Crystallex International Corporation v. Bolivarian Republic of Venezuela, ICSID Case No. ARB(AF)/11/2, Award, para. 669

This suggests that indirect expropriation may result from different regulatory measures taken together in a certain limited period of time that cumulatively have the effect of expropriation.[74] In the case of Biwater v. Tanzania, the investment tribunal endorsed the concept of creeping expropriation by stating that:

> "In terms of what might qualify as "expropriation", the Arbitral Tribunal accepts BGT's submission that it must consider the Republic's conduct both in terms of the effect of individual, isolated, acts complained of, as well as in terms of the cumulative effect of a series of individual and connected acts, in so far as such a cumulative effect might be to deprive the investor in whole or in material part of the use or economic benefit of its assets."[75]

[74] AlQurashi (2004), p. 900
[75] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, Award, para 455

4. The two doctrines

In the arbitration practice two main doctrines have evolved in order to determine when regulatory measures may amount to expropriation. These doctrines are the sole effects doctrine and the police powers doctrine. In this chapter I will introduce these two doctrines.

4.1. The sole effects doctrine

The sole effects doctrine determines the existence of an indirect expropriation, by solely examining the effect that a government measure has on the investment.[76] The rationale follows that if the government measure has the same depriving effect as in the case of direct expropriation, indirect expropriation has occurred. The sole effects doctrine finds its support from the wordings of the expropriation clauses. Many expropriation clauses expressly state that the state measure is to be deemed expropriatory due to its effects. These clauses use terms like "having the same effect" or "having a similar effect".[77] One example being the Article 13 of the ECT stating that: "Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalised, expropriated or subjected to a *measure or measures having effect equivalent to nationalisation or expropriation"*. Following the wordings of these clauses, the determinative factor seems to be quite evidently the effect of the measure. The use of these terms can be seen as a clear indication designed to assist the interpretation of the international tribunals.[78]

The sole effects doctrine disregards all the other parameters in the determination, and therefore, is an exclusive criterion. The damage suffered by the investor is the only factor that counts when determining whether an indirect expropriation has occurred also in a case where the depriving effect is caused by a general regulatory measure.[79] It is important to note that even though the sole effects doctrine concentrates on only to the effect of the measure, it does not deny the existence of the police powers of a state per se. It does recognize that not all regulatory measures that have a negative effect on the investment amount to an expropriation. In the light of the sole effects doctrine, general measures falling

[76] Dolzer (2002-2003), p. 79
[77] See more on the used wordings in chapter 3.4.1.
[78] Nikièma (2012), p. 6
[79] Nikièma (2012), p.13

in the police powers of the state consist of measures that do not deprive the economic value of the investment. Therefore, where a regulatory measure (or series measures) sufficiently deprives the value of the investment, the measure is deemed expropriatory, and is not seen as a legitimate use of the police powers.[80]

The challenge of applying the sole effects doctrine lies in quantifying the threshold of the economic impact.[81] In their rulings, investment tribunals have used the threshold of serious and irreversible damage caused to the investment. The terms "substantial", "serious" and "severe" are used to describe the severity of the damage suffered. The investment must, therefore, have lost all or near all economic interest for the investor.[82] Therefore, regulations that have adverse effects on the investment, but do not rise to this high threshold shall not be deemed expropriatory. This thesis does not even try to provide an answer to the question of the precise level of interference that shall be met in order for the act to be considered expropriatory. When determining where to exactly draw the line of the level of deprivation required, the common law method of fact sensitive case-by-case development might be the most practical method of legal development.

4.2. The police powers doctrine

According to the police powers doctrine, a state measure that falls within the accepted police powers of the state does not constitute an indirect taking, and the state does not have the obligation to pay compensation even though the measure would lead to deprivation of the investor's property. The police powers doctrine is often referred by stating that "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable".[83] The notion of police powers has roots in both common law and civil law systems, and it claims to find its legal support from the norms of customary international law. Even though the police powers doctrine was already recognized at the end

[80] Fortier & Stephen (2005), p. 85 and 93
[81] Gazzini (2010), p.38. Some investment tribunals have also concluded that deprivation might occur even if no loss of economic value has occurred, see Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, Award, para 464
[82] Nikièma (2012), p. 14
[83] Methanex Corporation v. United States of America, UNCITRAL, Final Award, para 7 Part IV - Chapter D

of the nineteenth century, and the beginning of the twentieth century by scholars and legal practitioners,[84] still to this day its scope and applicability in the context of expropriation claims remains uncertain. The two main interpretations of the police powers doctrine regarding indirect expropriation differ on whether all regulatory measures taken in public purpose shall be excluded from the scope of indirect expropriation, or only measures connected to the maintenance of health, moral and public order should be excluded.[85]

The criteria that the police powers doctrine uses when determining the existence of indirect expropriation consists of three cumulative factors. These factors are the legitimate public purpose of the measure, the non-discriminatory nature of the measure, and the compliance with the due process when enacting the measure.[86] One of the biggest obstacles of the police powers doctrine is connected to these factors that are to be used to determine whether a state measure is deemed expropriatory. The problem lies in the fact that the investment treaties explicitly use the same factors when determining the legality of an expropriation. Understandably using the legality criteria to construct that an expropriation has not occurred creates tension between the treaty clauses and the police powers doctrine, and is, therefore, highly controversial.

Before taking a closer look at how these two doctrines have been applied in the practice of investment tribunals, I will discuss shortly about the interpretation of investment treaties and the notion of conflict of norms in the next two chapters.

[84] Zamir (2017), p. 326-328
[85] Zamir (2017), p. 327
[86] Methanex Corporation v. United States of America, UNCITRAL, Final Award, para 1-28 Part II - Chapter D

5. The interpretation of the investment treaties

5.1. The rules of treaty interpretation

Even though the interpretation of treaties is no exact science, it is subject to certain rules.[87] The question of the scope of indirect expropriation in the investment treaty sphere is essentially a question of treaty interpretation. There are clauses regarding expropriation in the investment treaties, and what this thesis aims to find out is how these clauses should be interpreted and applied in the practice. Despite their special features, investment treaties are international agreements concluded between states in a written form and governed by international law as the Article 2(1)(a) of the VCLT provides. Therefore, also the rules of treaty interpretation are applicable. According to the rules of interpretation laid down in the Article 31 of the VCLT:

> ”1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
> (a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
> (b) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
> 3. There shall be taken into account, together with the context:
> (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
> (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
> (c) Any relevant rules of international law applicable in the relations between the parties.
> 4. A special meaning shall be given to a term if it is established that the parties so intended.”

[87] Crawford (2012), p. 378 and Yen (2014), p. 102

The general rule of interpretation expressed in the Article 31 has been seen also as a reflection of customary international law.[88] The general rule of interpretation is supported by the supplementary means of interpretation. According to the Article 32 of the VCLT:

> "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31 :
> (a) Leaves the meaning ambiguous or obscure; or
> (b) Leads to a result which is manifestly absurd or unreasonable."

Applicability of these rules in the investment treaty sphere might seem obvious, however, investment tribunals have rather often forgotten to acknowledge and carefully apply them in their rulings. As Yen has argued, investment tribunals have systematically neglected to acknowledge and apply the general rules of interpretation laid down in the VCLT. According to a review of 229 investment arbitration cases, a substantial number of the investment tribunals seem to forget to even mention the relevant articles of the VCLT, and many of the ones that do indeed mention the rules of treaty interpretation do not end up applying them appropriately in their rulings.[89] As Yen argues, the rules expressed in the Article 31 and 32 of the VCLT should be applied also in the investment arbitrations when a tribunal is applying and interpreting an investment treaty.

5.2. The principle of restrictive interpretation

The Permanent Court has in some cases expressed a principle of interpretation providing that clauses implying limitations to the state sovereignty shall be interpreted in a restrictive manner or in other words restrictions upon the sovereignty shall not be presumed.[90] This principle is not codified in the VCLT, and its position as a general principle of international

[88] Crawford (2012), p. 380
[89] Yen (2014), p. 104
[90] Crawford (2012), p. 379 and Lauterpacht (1949), p. 58

law is not secured. According to Lauterpatch, the principle of restrictive interpretation has been discouraged, and the occasional endorsement it has received has been rather nominal.[91]

5.3. Pacta sunt servanda and the Article 27 of the VCLT

The VCLT also expresses the principle of pacta sunt servanda. According to the Article 26 of the VCLT: "Every treaty in force is binding upon the parties to it and must be performed by them in good faith." This Article lays down the almost too obvious rule that once the treaty (including investment treaties) has entered into force parties are obliged to perform the treaty obligations in good faith. Therefore, pacta sunt servanda provides a high threshold for application for instance customary international law norms contradicting the treaty obligations. The principle of pacta sunt servanda has also achieved the status of a general principle of international law.[92]

The Article 26 is accompanied by the following Article 27 of the VCLT providing that "A party may not invoke the provisions of its internal law as a justification for its failure to perform a treaty". The Article 27 expresses the fundamental rule of the law of state responsibility concluding that a state cannot escape its international responsibility, by referring to its domestic legal situation. Therefore, this Article excludes the use of internal law as a defence in an international dispute settlement procedure.[93] The importance of this provision in the investment treaty context especially regarding regulatory expropriations is that a state cannot use the legitimacy of its internal regulations as a defence against expropriation claims.

[91] Lauterpacht (1949), p. 58
[92] Crawford (2012), p. 377
[93] Dörr & Schmalenbach (2012), p. 453-454

6. Conflict of norms?

One might consider approaching the tension between the investment protection and the public interest as an issue of conflict of norms. In this light, the norms regarding indirect expropriation would be seen conflicting with the international norms requiring the state to regulate in the public interest.[94] However, when taking a closer look, actual conflict between norms hardly exists in a case of indirect expropriation. According to the prevailing view in the academic writings on international law, a conflict between norms arises when a party cannot simultaneously comply with both norms.[95] If agreeing with this concept of conflict of norms, there is no conflict to be found between an expropriation clause, and an international law norm requiring states to regulate in the public interest. The expropriation clauses in the investment treaties, as stated before, do not prohibit expropriation, direct or indirect. This means that the host state is allowed to take action in the public interest and fulfill its international obligations. It is completely possible for the state to fulfill both obligations simultaneously.

Expropriation clauses only lay down requirements for lawful expropriation. The states usually do not have a problem with the requirements of public purpose, non-discrimination, and due process. What the states do have a problem with is the requirement of adequate compensation. However, the fact that a state has agreed to give adequate compensation when directly or indirectly taking the property of foreign investors does not in any way create a conflict between the expropriation clause and an international norm requiring the state to regulate in the public interest. Since no conflict of norms really exists, arguments relying on the idea of conflicting norms shall not be seen relevant or applicable. Solely the fact that fulfillment of one obligation makes it monetary costlier to fulfill another obligation does not mean that a legal conflict between norms exists. If one dares to argue that a treaty obligations shall be interpreted in a way that leads to the most monetarily affordable result for the host state, one ignores the basic principles that the international legal system is based on.

International environmental law treaties rarely play an essential role in the reasonings of investment tribunals. As a general trend investment tribunals have been reluctant to refer to the instruments of international environmental law. Consideration and acknowledgement

[94] Naturally a state shall not appeal to the conflict of the investor protection norms and the norms of national law since according to the Vienna Convention Article 27: "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."
[95] Vranes (2006), p. 395

of soft law instruments and the evolving principles of international environmental law are rather non existing. This portrays the general hesitancy of the investment tribunals to refer non-investment treaties in their reasonings regarding expropriations.[96] When accepting the rationale that there is no conflict between expropriation clauses requiring compensation and international norms requiring states to take regulative action, it also becomes understandable why many investment tribunals have been hesitant to refer to other international legal instruments. The reason might as well be that those other international legal instruments are not relevant especially when applying expropriation clauses. This will be also the reason why in this thesis, I will not refer to international law instruments regarding environmental matters when discussing the scope of indirect expropriation.

One should also note that international norms regarding environmental protection are still rather vague. The development of international environmental law is characterized by the evolution of standard-setting conventions. These conventions create international environmental regimes providing structure and resources for addressing environmental issues rather than a set of specific obligations that the state parties have to follow.[97] Therefore, states still have a lot of room to decide how they want to achieve the set goals regarding environmental protection without violating their international obligations regarding investment protection.

[96] Kulick (2012), p. 258-259
[97] Crawford (2012), p. 360

7. Case law analysis

7.1. Intro to the case law analysis

The purpose of this chapter is to examine how the investment tribunals have answered the question of indirect expropriation in cases where the expropriation claim was connected to regulatory measures taken with regard to environmental concerns. This case law analysis will concentrate especially on the following four questions:

1. How did the tribunal define the term indirect expropriation?
2. How did the tribunal initially examine the existence of indirect expropriation?
3. What meaning and weight were given to the public interest and the possible international obligation of the state to protect the environment?
4. What is the role and systematical placement of the police powers doctrine?

The aim of this kind of examination of the case law is to conclude that first, investment tribunals tend to determine the term indirect expropriation only, by referring to the effect that a measure has on the investment. Second, the initial way of determining the existence of an indirect expropriation is done by examining the effect that a government measure has on the investment. As to the weight given to the public interest no unified opinion exists in the practice. And finally, the systematic placement of the police powers doctrine together with the observations to the questions 1 and 2 indicates that the police powers doctrine is a possible exception criterion to the treaty obligation.

7.2. Santa Elena v. Costa Rica

The investment arbitration case Santa Elena v. Costa Rica was one of the first cases where the host state raised environmental public interest concerns, and referred to its international obligation to preserve the environment in the context of expropriation claims. This case did not directly discuss about the scope of indirect expropriation. In its reasoning the tribunal did, however, address the question of what meaning shall be given to the fact that a government measure was taken in the public interest relating to environmental concerns.

Compania´ del Desarrollo de Santa Elena (CDSE) purchased a property in Costa Rica in order to develop a tourist resort and a residential community. The majority of the company's shareholders where nationals of the United States of America. The government of the Costa Rica later issued a decree expropriating the property of the CDSE. CDSE accepted the expropriation, but contested the amount of compensation it was offered by the government of the Costa Rica.[98] In its reasoning regarding the expropriation claim, the tribunal refused to give any weight to the public interest of preserving the environment. The tribunal highlighted that the public interest behind the expropriatory act shall not affect the legal assessment of an expropriatory measure nor the obligation to pay compensation. According to the tribunal:

> "While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate, *the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid* for the taking. That is, the purpose of protecting the environment for which the Property was taken *does not alter the legal character* of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference."[99]

The Santa Elena tribunal was quite fast to disregard the environmental public interest arguments provided by Costa Rica. Also the fact that Costa Rica expropriated the property in order to fulfill its international law obligation to preserve the environment was given no weight.

7.3. Metalclad v. Mexico

The case of Metalclad v. Mexico was the first case to confront the delicate issue of waste disposal and the construction and operation of landfills. A Mexican company Confinamiento Tecnico de Residuos Industriales SA de CV (COTERIN) was granted a permit by the federal government of Mexico to construct and operate a transfer station and a landfill for hazardous

[98] Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica, ICSID Case No. ARB/96/1, Award, para 15-21
[99] Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica, ICSID Case No. ARB/96/1, Award, para 71 (emphasis added)

waste in the region of San Luis Potosi (SLP).[100] After receiving the permit, a U.S. corporation Metalclad purchased COTERIN with all its licenses.[101] After the purchase, the municipal government of SLP allegedly begin to take action in order to prevent the operation of the landfill.[102] The federal government of Mexico, however, continued to assure Metalclad that it was entitled to construct and operate the landfill.[103] Once the landfill began to operate, demonstrations opposing the operation of the landfill blocked the site of the landfill, and therefore, Metalclad was effectively prevented from operating the landfill.[104] After negotiations, the federal government of Mexico entered into a Convenio with the Metalclad permitting the operation of the landfill. The municipal government of the SLP, however, still refused to grant Metalclad a municipal permit for the operation of the landfill, and later issued an Ecological Decree that declared a Natural Area for the protection of a rare cactus. This Natural Area overlapped with the area of the landfill, and therefore, Metalclad was effectively and permanently precluded from operating the landfill.[105] Due to the acts of the municipal authorities and the issuance of the Ecological Decree, Metalclad claimed that the Respondent had indirectly expropriated its investment.

The Metalclad tribunal defined indirect expropriation by referring to the effect of the measure and stated that expropriation under NAFTA includes also:

> "-- covert or incidental *interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property* even if not necessarily to the obvious benefit of the host State"[106]

[100] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 28-29
[101] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 35
[102] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 37
[103] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 41
[104] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 46
[105] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 59
[106] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 103 (emphasis added)

Accordingly, the tribunal initially examined the existence of indirect expropriation, by examining the effect that the government conduct had on the investment, and came into the conclusion that the investment of the Metalclad was expropriated.[107]

As to the weight that shall be given to the public interest behind the measure the tribunal stated that:

> "The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. -- However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation."[108]

The tribunal refused to consider the legitimate motivation or intent behind the issuance of the Ecological Decree. Therefore, the tribunal denied the idea that the intent or motive behind a regulatory act could have any meaning when determining whether an indirect expropriation has occurred. Only the fact, that the issuance of the said Decree had the effect of depriving the investor of the economic benefit of the property, was considered decisive.

7.4. Biwater v. Tanzania

The case of Biwater v. Tanzania concentrated on the issues relating to water and sewer infrastructures. Biwater Gauff (Tanzania) Limited made a bid, and got the right to develop a water and sewer infrastructure and services project in Tanzania. Biwater formed a company, City Water, to execute the project. City Water entered into contracts governing the projects with the government Water and Sewerage Authority. The City Water, however, was confronted with financial and practical difficulties that prevented it from meeting the set performance guarantees. Tanzania decided to terminate the project contract, and deport the senior management of the City Water. New management was ordered to take control of the assets of the company.[109] According to Biwater Tanzania had indirectly expropriated its investment due to the acts described above.

[107] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 104-112
[108] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award, para 110
[109] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, para 95-228

The Biwater tribunal defined indirect expropriation also by referring to the effect and stated that:

> "The Treaty encompasses not only direct expropriation (i.e. a formal Government taking) but also de facto or indirect expropriations which do not involve actual takings of title but nonetheless result in the effective loss of management, use or control, or a significant depreciation of the value, of the assets of a foreign investor."[110]

Accordingly, the tribunal moved on to examine the effect of the government measures. While examining the effect of the government conduct, the tribunal came into a conclusion that the effect must not always be economic and stated that:

> "Equally, whilst accepting that effects of a certain severity must be shown to qualify an act as expropriatory, there is nothing to require that such effects be economic in nature. A distinction must be drawn between (a) interference with rights and (b) economic loss. A substantial interference with rights may well occur without actually causing any economic damage which can be quantified in terms of due compensation. In other words, the fact that the effect of conduct must be considered in deciding whether an indirect expropriation has occurred, does not necessarily import an economic test." [111]

The tribunal justified its interpretation by the rules of treaty interpretation and concluded that:

> "In this case, the BIT does not include "economic damage" as a requirement for expropriation, and the Arbitral Tribunal does not consider that it must or should be imported."[112]

[110] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, para 452
[111] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, para 464
[112] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, para 467

At the end the tribunal concluded that expropriation had occurred.[113] As to the public interest concerns, the tribunal did not give any weight to the possible public interest behind the government measures. It only rather quickly stated that:

> "The Arbitral Tribunal recognises that many tribunals in other cases have tested governmental conduct in the context of indirect expropriation claims by reference to the *effect* of relevant acts, *rather than the intention behind them*."[114]

7.5. Chemtura Corporation v. Canada

In the case of Chemtura Corporation v. Canada, the tribunal was confronted with a dispute relating to the use of environmentally harmful chemicals. Chemtura was a manufacturer of a lindane-based pesticide. Lindane had been banned in numerous countries due to its harmful effects on the health and environment. Canada decided to also enact regulation banning the use of lindane in its territory. This according to Chemtura constituted an indirect expropriation of its investment. [115]

The tribunal first determined indirect expropriation, by referring to the effect of substantial deprivation by stating that:

> "For a measure to constitute expropriation under Article 1110 of NAFTA, it is common ground that (i) bad faith on the part of the Respondent is not required, and (ii) t*he measure must amount to a substantial deprivation* of the Claimant's investment."[116]

The tribunal examined the existence of indirect expropriation initially, by applying a substantial deprivation test. According to the tribunal:

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[113] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, para 485

[114] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, para 463 (emphasis added)

[115] Chemtura Corporation v. Government of Canada, UNCITRAL (formerly Crompton Corporation v. Government of Canada), Award, para 92-93

[116] Chemtura Corporation v. Government of Canada, UNCITRAL (formerly Crompton Corporation v. Government of Canada), Award, para 242 (emphasis added)

> "-- in assessing whether the Claimant has suffered an indirect expropriation or a measure tantamount to expropriation, the Tribunal must determine whether the measures challenged under this heading, i.e. the cancellation of Chemtura Canada's lindane registrations, amounted to a "substantial deprivation" of the Claimant's investment."[117]

The tribunal executed the examination, by concentrating on the economic effect that the government measures had on the investment, and concluded that the effects did not amount to substantial deprivation.[118]

The public interest behind the government measure was recognized by the tribunal and it endorsed the police powers doctrine after having already concluded that no indirect expropriation had occurred and stated that:

> "-- the measures challenged by the Claimant constituted a valid exercise of the Respondent's police powers. As discussed in detail in connection with Article 1105 of NAFTA, the PMRA took measures within its mandate, in a non-discriminatory manner, motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation."[119]

When endorsing the police powers doctrine, the tribunal had clearly first determined the existence of indirect expropriation. The police powers doctrine seems to be, hereby, endorsed as a possible exception/justification criterion.

7.6. S.D. Myers v. Canada

The case of S.D. Myers v. Canada confronted the difficult question of hazardous waste. S.D. Myers, Inc. (SDMI) was a U.S. corporation that processed and disposed of an environmentally hazardous chemical compound polychlorinated biphenyl (PCB). SDMI

[117] Chemtura Corporation v. Government of Canada, UNCITRAL (formerly Crompton Corporation v. Government of Canada), Award, para 259
[118] Chemtura Corporation v. Government of Canada, UNCITRAL (formerly Crompton Corporation v. Government of Canada), Award, para 265
[119] Chemtura Corporation v. Government of Canada, UNCITRAL (formerly Crompton Corporation v. Government of Canada), Award, para 266

created an affiliate in Canada in order to obtain PCB waste, and treat it in the SDMI's facilities in the U.S.. Promptly after SDMI was granted a permission to import PCB waste to the U.S. from Canada by the U.S. government, Canada issued an order that banned the export of PCB waste to the U.S..[120] SDMI claimed that, among other breaches of the NAFTA Chapter 11, Canada had indirectly expropriated its investment. Canada on the other hand claimed that the ban was due to environmental concerns, and did not constitute expropriation.

The tribunal started the analysis by acknowledging the tension between regulatory acts and acts constituting expropriation. The tribunal, however, ended up defining indirect expropriation by stating that:

> "An expropriation *usually amounts to a lasting removal of the ability of an owner to make use of its economic rights* although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary."[121]

Even though the tribunal stated, that it shall look both to the effect and to the purpose of the government measure when examining the existence of indirect expropriation, the tribunal did not examine the purpose behind the measure in its reasoning.[122] The tribunal examined the existence of expropriation initially, by examining the effect that the government measure had on the investment. Since the measure was temporary and postponed the Claimants venture to the market only for 18 months, the tribunal concluded that the effect did not amount to expropriation.[123]

In a separate opinion, Dr. Bryan Schwartz argued for the need for separating normal regulation and expropriation.[124] However, Schwartz also concluded that regulations cannot be per se excluded from the scope of indirect expropriations by stating that:

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[120] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Partial Award, para 88-128
[121] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Partial Award, para 283 (emphasis added)
[122] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Partial Award, para 281 and 285
[123] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Partial Award, para 284-287
[124] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Separate Opinion by Dr. Bryan Schwartz (on the Partial Award), para 203

> "I cannot make a categorical statement that Article 1110 can never address a governmental measure that is presented as a regulation."[125]

Schwartz seems at the end also to endorse the idea of the effect as a dividing factor between normal regulation and measures constituting expropriation by stating that:

> "Expropriations tend to be severe deprivations of ownership rights; regulations tend to amount to much less interference."[126]

7.7. Burlington v. Ecuador

The case of Burlington v. Ecuador was a case regarding oil production. Burlington Resources Inc. invested in several oil production facilities in Ecuador. Due to a substantial rise in oil prices, a new tax regulation imposing a 50 per cent tax on the extraordinary profits of the oil companies was enacted. Later Ecuador raised the tax to 99 per cent. Due to Burlington's decision of stopping to pay the tax, Ecuador seized and auctioned off Burlington's shares of the oil production. Ecuador also took possession of the production facilities after Burlington threatened to stop the production, and annulled the production services contracts by a ministerial decree.[127] Burlington claimed that due to these actions its investment was indirectly expropriated.

The Burlington tribunal first addressed the concept of creeping expropriation while simultaneously determining indirect expropriation by the effect of the measure (or measures). Accordingly, the tribunal moved on to examine the effect of each alleged measure in order to conclude whether the measures alone or together would constitute indirect expropriation.[128] The tribunal had to first consider when tax regulation could be deemed expropriatory. The tribunal interestingly first notes that even though "taxation is an essential

[125] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Separate Opinion by Dr. Bryan Schwartz (on the Partial Award), para 206
[126] S.D. Myers, Inc. v. Government of Canada, UNCITRAL, Separate Opinion by Dr. Bryan Schwartz (on the Partial Award), para 211
[127] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 1-66
[128] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 348

prerogative of State sovereignty", there are limits to the state's power to tax found in customary international law.[129] According to the tribunal:

> "Customary international law imposes two limitations on the power to tax. Taxes may not be discriminatory and they may not be confiscatory. -- Among the factors to be considered one counts first and foremost the tax rate and the amount of payment required. If the amount required is so high that taxpayers are forced to abandon the property or sell it at a distress price, the tax is confiscatory."[130]

According to the tribunal, the concept of confiscatory taxation appears to correspond to expropriatory taxation.[131] The tribunal further stated that the most important factor in order to determine whether taxation is confiscatory and expropriatory is the effect of the tax.[132] The tribunal also noted that:

> "When assessing the evidence of an expropriation, international tribunals have generally applied the sole effects test and focused on substantial deprivation."[133]

Accordingly, the tribunal examined the existence of indirect expropriation initially by examining the effect that the regulatory measures of the government had on the investment.[134]

The Burlington tribunal, however, also endorsed the police powers doctrine, but clearly as a justification/exception doctrine. The placement of the police powers considerations would be, therefore, after the initial assessment of the existence of an expropriation. The tribunal demonstrated this, by stating that assessment of indirect expropriation follows a three-tier analysis:

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[129] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 391-392
[130] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 393
[131] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 394
[132] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 395
[133] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 396
[134] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 420-540

> "Accordingly, a State measure constitutes expropriation under the Treaty if (i) the measure deprives the investor of his investment; (ii) the deprivation is permanent; and (iii) the deprivation finds no justification under the police powers doctrine."[135]

7.8. Methanex v. United States of America

Another case confronting the issue of environmentally harmful chemicals was the case of Methanex v. United States of America. Due to environmental concerns the state of California prohibited the use of MTBE (methyl tert-butyl ether) because it was causing pollution in the surface water and the groundwater. Methanex a Canadian corporation was a leading manufacturer of methanol in the American market. Methanex did not produce MTBE. However, a large percentage of the methanol it manufactured was used in the production of MTBE.[136] Among other breaches of Chapter 11 of NAFTA, Methanex claimed that by banning the use of MTBE the U.S. had taken measures amounting to expropriation.

The Methanex tribunal did not provide any determination for indirect expropriation. It went straight to endorsing the police powers doctrine and stated that:

> "But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment *is not deemed expropriatory* and *compensable* unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation."[137]

The Methanex tribunal also stated regarding the intent behind the alleged expropriatory measure that:

[135] Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, para 506
[136] Methanex Corporation v. United States of America, UNCITRAL, Final Award, para 1-28 Part II - Chapter D - Page 1-10
[137] Methanex Corporation v. United States of America, UNCITRAL, Final Award, para 7 Part IV - Chapter D - Page 4

> "In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation."[138]

The tribunals statement that an intentionally discriminatory regulation would be a constructive criterion when determining the existence of indirect expropriation is a bit out of place. A non-discriminatory nature of the measure is a requirement of lawful expropriation. This means that the discriminatory nature of the act would be a key requirement for establishing that the expropriation was unlawful, but cannot determine whether an expropriation has occurred. The tribunal came into the conclusion that no expropriation had occured since the measures take by the U.S. were for a public purpose, non-discriminatory and accomplished with due process, and therefore, the requirements that the police powers doctrine provides were fulfilled.[139]

7.9. Tecmed v. Mexico

In the case of Tecmed v. Mexico, an investment tribunal was once more confronted with the issues relating to hazardous waste. Tecnicas Medioambientales Tecmed S.A. (Tecmed) subsidiary of a Spanish investor bought a landfill of hazardous waste and related assets including a permit that was necessary in order to operate the landfill. Tecmed claimed that Mexico had indirectly expropriated its investment due to the fact that Mexican authorities refused to renew the permit that was necessary in order for Tecmed to operate the landfill.[140]

The Tecmed tribunal also defined indirect expropriation by reffering to the effect of a government measure and stated that:

> "Although these forms of expropriation do not have a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, *which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect*."[141]

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[138] Methanex Corporation v. United States of America, UNCITRAL, Final Award, para 7 Part IV - Chapter D - Page 4

[139] Methanex Corporation v. United States of America, UNCITRAL, Final Award, para 15 Part IV - Chapter D - Page 7

[140] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 35-51

[141] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 114 (emphasis added)

Accordingly, the tribunal stated that the initial way of determining whether an indirect expropriation has occurred is to be executed, by examining the effect of the regulatory measure. According to the tribunal:

> "To establish whether the Resolution is a measure equivalent to an expropriation under the terms of section 5(1) of the Agreement, it *must be first determined* if the Claimant, due to the Resolution, *was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto* —such as the income or benefits related to the Landfill or to its exploitation— *had ceased to exist*. In other words, if *due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss*. This determination is important because it is one of the *main elements to distinguish*, from the point of view of an international tribunal, *between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a de facto expropriation that deprives those assets and rights of any real substance*."[142]

The Tecmed tribunal also proceeded to interpret the expropriation clause according to the general rules of treaty interpretations and notified that:

> "After reading Article 5(1) of the Agreement and interpreting its terms according to the ordinary meaning to be given to them (Article 31(1) of the Vienna Convention), we *find no principle stating that regulatory administrative actions are per se excluded from the scope of the Agreement*, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever."[143]

The tribunal, however, stated that in order to determine whether the state measures are to be deemed expropriatory, it has to examine whether the measures are proportional to the public interest presumably pursued. The tribunal concluded that the effect will play a key role in the proportionality analysis.[144] According to the tribunal:

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[142]Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 115 (emphasis added)
[143] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 121 (emphasis added)
[144]Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 122

> "There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure. To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not."[145]

The tribunal came into the conclusion that the measures taken in the purpose of protecting the environment were not proportional to the effect caused to the interests of the investor and concluded that expropriation had occurred.[146] The tribunal referred to the practice of the ECHR to support the endorsement of the proportionality analysis.[147] The transplantation of the proportionality analysis from the practice of the ECHR is, however, problematic for several reasons, and as expected the Tecmed tribunal did not manage to apply the proportionality analysis in an appropriate manner. The problem of transplanting the proportionality analysis from the practice of the ECHR will be discussed in detail later.

7.10. Conclusions of the case law analysis

After examining the case law, it seems to be rather evident that the term indirect expropriation is determined, by a reference to the depriving effect of a government measure. The same conclusion can be made when examining the academy writings.[148] Even scholars, that do endorse the police powers doctrine, determine the term indirect expropriation initially by referring to the effect of the measure. Also it seems to be quite obvious that the initial way to determine the existence of indirect expropriation has been executed, by examining the effect that a government measure has on the investment.[149]

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[145] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 122
[146] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 151
[147] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 122
[148] AlQuarshi (2004), p. 897; Dolzer & Schreuer (2012), p. 101; Nikièma (2013), p. 4; Opritoiu (2012) p. 202; Soloway (2000), p. 101 and Zamir (2017), p. 319
[149] This observation is supported by the study of the case law executed by López. López (2014) p. 134

As to the observations to the question of the weight given to the public interest concerns, no unified opinion was found. Some tribunals explicitly stated that the public interest of protecting the environment has no weight in the determination of whether an indirect expropriation has occurred while some recognized the idea of public interest, but the consideration of it was rather non existent in their rulings. Tribunals endorsing the police powers doctrine gave the most considerable weight to the public interest.

The placement and way of endorsement of the police powers doctrine in the practice suggest that the police powers doctrine is an exception doctrine. Also the way in which the police powers doctrine is endorsed in the academy writings would suggest the same.[150] Following this rationale, the determination of the existence of an indirect expropriation would follow the sole effects doctrine, and the police powers doctrine would provide a possible exception. When acknowledging the role of the police powers doctrine as an exception to the main rule (determining the existence of indirect expropriation by examining the effect), one must also adjust the legal arguments to comply with this role. Since the terms used in the expropriation clauses normally do not contain any exceptions to the main rule, in order to legally support the police powers doctrine, one must prove that there is a norm of customary international law providing this exception to the treaty rule.

[150] Dolzer (2002-2003), p. 80; Epps (2013), p. 150 and Mofasa (2008), p. 272-273

8. The Critique

8.1. The purpose of the critique

One could see that the purpose of this critique is just to make an argument that the sole effects doctrine is a more appropriate method to determine when regulation amounts to expropriation. This is partly true. I do believe that in the current state of the international investment law, the sole effects doctrine should prevail. However, I do not wish to deny that the police powers doctrine might have some potential. Considering that in the current political climate the police powers doctrine is often seen as the more legitimate one, it is expected that regardless of its shortcomings, this doctrine is gonna keep on developing and evolving in the practice. Therefore, the second function of this critique is to provide constructive criticism that can possibly guide the development of the police powers doctrine into a more legally sustainable one.

I will execute the critique, by first analysing the legal support found for each doctrine from the investment treaties and the customary international law. After that, I will discuss separately the issue of finding balance between the competing legitimate interests and the possibility of utilizing the proportionality analysis developed in the practice of ECHR in the context of indirect expropriations.

8.2. The lack of legal support from the investment treaties

I will start the critique of the police powers doctrine with the argument of the most fundamental weight, and that is the lack of legal support from the investment treaties. As discussed in chapter five, the VCLT applies to the investment treaties. Therefore, the rules of treaty interpretation shall be applied when interpreting the expropriation clauses. Let us take one more look at the representative expropriation clause, the Article 13(1) of the ECT. According to the Article 13 (1):

> "Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or *subjected to a measure or measures having effect equivalent to nationalization or expropriation* (hereinafter referred to as "Expropriation")

except where such Expropriation is:

(a) for a purpose which is in the public interest;

(b) not discriminatory;

(c) carried out under due process of law; and

(d) accompanied by the payment of prompt, adequate and effective compensation."[151]

When interpreting this expropriation clause in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose, its quite hard to find any support for the police powers doctrine.

When interpreting the expropriation clause according to the ordinary meaning of the terms, it seems quite evident that no type of government measure is excluded from the scope of the clause. As seen in the case law review, the Tecmed tribunal initially made the same observation.[152] Also considering that many treaties explicitly define indirect expropriation through the effect of the measure, the ordinary meaning would lead quite clearly to the application of the sole effects doctrine. In addition to that, the text of the expropriation clauses does not leave any room for exceptions of any kind. The text expresses very clearly that if a government takes a measure that has the same effect as direct expropriation, the investor is entitled for adequate compensation. The text itself leaves no room for discretion on this regard. There are also no exceptions regarding the obligation to pay compensation according to text of the treaties. One must use quite a lot of imagination to find any support for the police powers exception from the wording and terms of the expropriation clauses.

While the police powers doctrine not only finds no support from the text of the treaty, it also contradicts the whole provision regarding indirect takings, by borrowing the requirements of lawful expropriation, except of course the requirement of adequate compensation. It cannot be in accordance with the good faith interpretation of the treaty text that the police powers doctrine takes part of the legality criteria and turns it into an exception criteria. By borrowing the criteria of lawful expropriation, the police powers doctrine

[151] The Article 13(1) of the ECT continues: "Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").
Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment."

[152] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 121

diminishes the text of the treaty. Because the public purpose, according to the text of the treaty, shall be treated as a legality requirement, it shall not simultaneously work contradictingly as an exception criterion.[153] Therefore, the public purpose of the measure should not be taken into account when determining the existence of an expropriation.[154] The same can be said of the requirements regarding the non-discriminatory nature and the due process of the measure. Also using the criteria of 'general regulation' as a divider is rather problematic due to the broadness of the term, and the fact that the main way of a state to indirectly expropriate foreign property is by using some type of regulatory measure considering that the criteria of lawful expropriation require the state to follow the due process. If one would exclude all general regulatory measures from the scope of indirect expropriation, the protection against indirect expropriations would largely lose its meaning. As concluded in the case law study, the police powers doctrine is an exception doctrine. Interpreting a treaty text in a good faith also does not allow one to come up with an exception to the treaty text that has no support from the text of the treaty, and in addition diminishes the text of the treaty.

Finding support for the police powers doctrine from the context and the object and purpose of the investment treaties is also tricky. The fundamental purpose of the investment treaties is undeniably the protection of foreign investors in order for the host state to attract more foreign capital.[155] Even though some treaties might also give notice to the state's right to regulate in the preamble,[156] this does not create a strong enough foundation to interpret the treaty by contradicting the ordinary meaning given to the text.

The VCLT Article 31(3)(c) does leave a small door open for the "relevant rules of international law applicable in the relations between the parties". However, as noted in chapter five, no conflict between expropriation clauses and norms requiring the state to take action in the public interest exists. Therefore, international treaties obliging the state to regulate are in line with the textual interpretation of the expropriation clauses.

Since interpreting the expropriation clauses according to the Article 31 does not leave the meaning ambiguous or obscure, nor does it lead to a result that is manifestly absurd or

[153] Nikièma (2012), p.7
[154] Fortier & Stephen (2005), p. 94
[155] For example Finland - India BIT Preamble, Finland - Hong Kong China SAR BIT (2009) Preamble and Norway - Chile BIT Preamble and Pohl (2018), p. 7
[156] For example EU- Canada The Comprehensive Economic and Trade Agreement (CETA) Preamble

unreasonable, there is no need for using the supplementary means of interpretation laid down in the Article 32 of the VCLT.

Therefore, it shall be concluded that the police powers exception does not find any legal support from the investment treaties themselves. The sole effects doctrine on the other hand finds its legal support from the text of the investment treaties, and according to the rules of treaty interpretation should prevail. Next, it is essential to turn to the customary international law, and examine whether sufficient legal support for the police powers exception could be found there.

8.3. The lack of support from customary international law

Due to the complete lack of support from investment treaties, the police powers doctrine usually turns to the customary international law to find legal support. The Article 38 of the ICJ Statute recognizes the norms of customary international law as a source of international law besides treaties and general principles of international law. To refresh the mind, customary international law consists of general practice accepted as law.[157] Since a profound examination of the existence of a customary international law norm would require extensive research, that cannot be provided in this thesis, rather than trying to establish the existence of a customary international law norm, I will concentrate on pointing out factors that indicate against the existence of a such norm.[158] Since the notion of the police powers of a state is recognized by both of the doctrines, the existence of the police powers of a state per se under customary international law is not questioned here. This examination concentrates on examining whether there is a customary international law norm that would provide an exception to the investment treaty provisions regarding indirect expropriation, by excluding regulatory measures from the scope of indirect expropriations.

The first factor indicating that no general practice exists excluding regulatory measures from the scope of indirect expropriations, is the fact that no unified opinion among the scholars, nor in the practice of the arbitration tribunals exists regarding such a norm. Almost all the scholars writing about the scope of indirect expropriation state that no unified opinion

[157] Crawford (2012), p. 25 and the ICJ Statute Article 38
[158] Zamir (2017), p. 328

exists on how to determine the existence of a regulatory expropriation.[159] It became also evident when examining the case law that in practice no unified opinion exists regarding the police powers exception. The question of when regulatory measures of the state shall be deemed expropriatory is described as controversial and highly disputed. As Soloway puts it:

> "Generally, both domestic and international law distinguish between the exercise of police power on the one hand and expropriation on the other. However, *there does not appear to be any universally agreed set of principles as to when one government action should fall into one category and another in the other*".[160]

Naturally, the fact that the exact scope of a customary international law norm is disputed does not necessarily mean that the norm does not exist. However, it is a strong indicator that the existence of such norm is rather questionable. Also in the case of indirect expropriation, it is not only the scope of the police powers exception that remains disputed, but the existence of the exception itself as well.

The second factor indicating against the existence of the police powers exception is the fact that the ECHR has not recognized such exception in its practice when interpreting the right to property. According to the Protocol 1 Article 1 (Protection of property) :

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

The ECHR has not concluded that regulatory measures of the state would be excluded from the scope of this Article. Sometimes the practice of the ECHR has been referred to when arguing for the existence of the police powers exception.[161] This line of argument has, however, confused several factors with each other. First, it has been suggested that in the

[159] AlQuarshi (2004), p. 926; Isakoff (2013), p. 169-167; López (2014), p. 134; Mofasa (2008), p. 268; Nikièma (2013), p. 4; Schill (2010), p. 149; Soloway (2000), p. 102, Waelde & Kolo (2001), p. 811-813 and Zamir (2017), p. 337
[160] Soloway (2000), p. 102 (ephasis added)
[161] For example OECD (2004), p. 7

practice of the ECHR it is rather uncommon that the court would rule that a regulation would constitute a deprivation of property. However, the reason for this is not the fact that the ECHR excludes regulatory measures from the scope of de facto expropriation, but the fact that the ECHR has applied a high threshold for the effect that is required for a measure to constitute de facto expropriation.[162] The ECHR, therefore, follows the sole effects doctrine when determining the existence of de facto expropriation. Second, the placement of the public purpose arguments in a case of a deprivation of property and in a case of control of the use of property is in the stage of determining whether the state measure was permissible.[163] Therefore, in the practice of the ECHR the public purpose is not considered in the stage of determining if a de facto expropriation or a control of the use of property has occurred. The legitimate public purpose comes into consideration when determining the lawfulness of such measure. Following this, the public interest considerations shall be placed in the stage of considering the lawfulness of an expropriation, and not in the stage of determining whether an expropriation has occurred as also the text of the expropriation clauses provides.

When interpreting the Protocol 1 Article 1 in practice, the ECHR has considered that in the case of de facto expropriation compensation is always required regardless of the public purpose of the measure even though the Article itself does not explicitly require it. The public purpose might in some circumstances reduce the amount of compensation that the state has to pay, but still some amount of compensation is required.[164] Only in a case of a national emergency could the non-payment of the compensation be justified.[165] In cases where the state interference does not amount to de facto expropriation, but is seen as a control of the use of the property, the amount of compensation paid is considered an important factor when determining if the measure was proportional.[166] The ECHR has not, therefore, endorsed the police powers exception even though the text of the Protocol 1 Article 1 would be much more open to such considerations.

As a third factor, I will discuss the US Restatement of Foreign Relations Law that is often cited in order to support the police powers exception. While the Restatement does endorse the idea of the police powers of a state, it does not exclude general regulatory measures per se from the scope of indirect takings. Even in a core area of practice of the

[162] Boute (2010), p. 113-114, Hirvelä (2017), p. 1261-1263 and Pohl (2018), p. 10-11
[163] Grgić, Mataga, Longar & Vilfan (2007), p. 12
[164] Pellonpää (2018), p. 1068-1073
[165] Hirvelä (2017), p. 1263-1264
[166] Hirvelä (2017), p. 1272-1273

state's police powers, such as enacting tax regulation, the Restatement recognized the possibility that the tax regulation might be deemed confiscatory due to the effects of such measures. The possibility to tax measures to constitute expropriation has also been recognized by scholars and legal practice.[167] According to the Restatement:

> "A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory."[168]

It has been acknowledged also in the practice of the investment tribunals that tax legislation, while enacting it usually is legitimate use of police powers, is under customary international law subject to restrictions. As seen in the case law review, the Burlington tribunal recognized that under the customary international law tax regulation shall not be confiscatory. The confiscatory nature of the tax measure is determined by the effect of the measure. Enacting tax regulation is seen as a fundamental part of the police powers of the state, however, it seems like it is generally accepted that even the right to enact tax regulation is subject to restrictions regarding the effect of such regulation.

The position of the police powers exception as a norm of customary international law is also problematic with regard to the Article 27 of the VCLT. Just to repeat the Article 27 provides that a state may not invoke the provisions of its internal law as a justification for its failure to perform a treaty. Expropriation provisions provide that a state shall not expropriate foreign investment directly, or take measures with equal effects unless the given requirements are met. Therefore, a state has an international obligation to either refrain from taking measures with equal effects to direct expropriation, or to comply with the given requirements. A state shall not invoke the provisions of its internal law as a justification to not to perform this obligation. In a case where a state takes regulatory measures causing the effect of expropriation, the state cannot justify its non-performance of the treaty obligations, by referring to the legitimacy of its internal law. Now repeating what the police powers exception actually attempts to say is that even if a state takes measures that cause the same effect as direct expropriation, the state does not have to comply with the treaty obligations

[167] Epps (2013), p.153
[168] Soloway (2000), p. 103 and American Law Institute, Restatement of the Law: The Foreign Relations Law of the United States,Vol. 2 (St. Paul, American Law Publishers, 1987), §712

(especially the requirement of compensation) because the failure to perform the treaty is caused by legitimate internal legislation. Naturally, the police powers doctrine relies on the support of the customary international law, and therefore, it can escape the initial scrutiny of this provision. What is, however, important to note is that since the police powers exception basically contradicts the rule expressed in the Article of 27 of the VCLT, the need for the police powers exception to find strong enough legal support from the customary international law shall not be overlooked.

As a last factor, I will discuss the contrived placement of the police powers exception. The supporters of the police powers doctrine seem to be quite confused, more or less intentionally, whether or not the police powers doctrine is a doctrine that determines whether or not an expropriation has occurred or a doctrine that excludes the obligation of the state to pay compensation if the expropriation is caused by a legitimate use of police powers. It seems like the importance of this differentiation has been disregarded, and presented only as an intellectual or scholarly problem that makes no real difference in practice. As Mofasa states:

> "Whether this is because the exercise of police powers precludes the measure being regarded as expropriatory, or whether it merely provides an exception to the rule that compensation must be paid for expropriation, is ultimately an academic question. The end result is the same: the police powers doctrine operates to exclude the State's liability." [169]

Does it then really bear fruit to question whether the function of the police powers doctrine is to determine whether expropriation has occurred or to exclude the obligation of the state to pay compensation? In my opinion, this classification is extremely important. Without knowing the difference, one cannot build sufficient legal arguments to support the police powers exception. Determination of whether an expropriation has occurred, and on the other hand the level of compensation that the state is obliged to pay are two distinct issues in international law. Considering the high level of controversy still surrounding the determination of indirect expropriation, and the rather questionable position of the police powers exception under the customary international law, sufficient legal arguments shall not be overlooked. As the police powers doctrine clearly establishes acceptability/justification criteria and not constructive criteria, it seems like the purpose of the police powers exception is to exclude the obligation to pay compensation. According to the police powers exception,

[169] Mofasa (2008), p. 273

if certain acceptability criteria are met, the state should not be obliged to pay compensation. It is also common in the academy writings to refer to the police powers as an exception to the obligation to pay compensation.[170] This clearly indicates that systematically the police powers doctrine should be understood as a doctrine excluding the duty to pay compensation. The police powers doctrine does not in any way differentiate whether a certain act happened or not. As seen in the case law review, the tribunals initially examine the existence of indirect expropriation, by examining the effect of a measure and not by the criteria provided by the police powers exception.

Once agreed that the police powers exception is an exception regarding the obligation to pay compensation, the placement of police powers considerations should be in the stage of determining the amount of compensation and not in the stage of determining whether an expropriation has occurred. The supporters of the police powers doctrine might be reluctant to admit this since once accepting this, one must find strong enough legal arguments to counteract the clear treaty obligation that leaves no room for discretion. The investment treaties are very clear that if a direct or an indirect expropriation has occurred, the state has to pay adequate compensation. To counteract this strong rule, clearly laid down in the treaty text, might end up being too big of a task to tackle for the police powers exception. The transplantation of the police powers doctrine to the stage of determination of the existence of an expropriation can be seen as proof of its inadequacy. If the police powers exception would have strong enough legal support to make an exception to the compensation standard, it would not be transplanted to a place it does not initially belong. The only reason for its contrived transplantation to the stage of determining the existence of an expropriation is that it is not strong enough to contradict the rule that every expropriation shall be compensated.[171]

Considering all these factors, the idea that the police powers exception should be considered as general practice accepted as law is hard to attain. Therefore, I cannot but conclude that the police powers doctrine does not find sufficient legal support from the customary international law.

[170] Gazzini (2010) p. 50; Fortier & Stephen (2005), p. 84-86; OECD (2004), p. 3-5; Schill (2010), p. 149 and Wagner (1999), p. 526 and 528
[171] Nikièma (2013), p. 15

8.4. Search for the balance

A trend in the recent decisions and academy writings has been the search for a balance between the conflicting interests of the host state and of the investor.[172] The interest of the investor is to seek protection against the expropriatory acts of the host state. The interest of the host state on the other hand is to maintain wide regulatory freedom in order to act in the public interest. In the context of this thesis, the pursued public interest would be the protection of the environment. Both of the interests are legitimate. Since the problematic surrounding indirect expropriation is seen as a problem of two competing interests, the main question the scholars often try to answer is the question of how should the regulatory interests of the host state and the interest of the investor be 'balanced' in the case of indirect expropriation. The main argument for the use of police powers doctrine has been its alleged ability to balance the conflicting interests of the investor and of the host state. However, the way the police powers doctrine is currently applied in the stage of determination whether an indirect expropriation has occurred does not have much of the claimed balancing ability. The police powers doctrine, used in the determination of whether an indirect expropriation has occurred, only endorses the either-or nature of the expropriation clauses. If the police powers exception would apply, the investor would not be entitled to any amount of compensation even though the state measure would deprive the economic benefit of the investment. One could hardly call this balanced. It is hard to argue that in a case where an investment loses all its economic value due to a state act, balance would be struck when the investor would get no compensation at all. According to the ECHR:

> "the taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1 (P1-1). Article 1 (P1-1) does not, however, guarantee a right to full compensation in all circumstances. Legitimate objectives of "public interest", such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value."[173]

This expresses the view of the ECHR that a balance could hardly be found in a situation where no compensation would be given to the owner of the deprived property. Considering

[172] Fortier & Stephen (2005), p. 83 and Nikièma (2012), p. 4
[173] James and Others v The United Kingdom, ECHR 21 Feb 1986, para 54

this, it becomes quite clear that when used in the stage of determination whether an indirect expropriation has occurred, the police powers doctrine does not have the claimed balancing ability due to the either-or function of the expropriation clauses.

Reciprocally, the main argument against the sole effects doctrine has been its inability to balance the conflicting interests of the investor and of the host state. However, when taking a closer look, the sole effects doctrine can be even better in the balancing than the police powers doctrine. I would dare to go even further, and argue that the sole effects doctrine is the product of balancing the conflicting interests. As stated before, the sole effects doctrine does not deny the existence of the police powers of the state. It does acknowledge that not every negative regulatory interference of the state is to be deemed expropriatory. Only when a government measure deprives all or near all economic value of the investment, the act is deemed expropriatory and compensation shall be paid. As argued above, one can hardly see the interest balanced when the investment loses all of its economic value due to a state measure, and the investor is provided no compensation at all.

It is interesting that in case of direct expropriation the idea that the owner is entitled for compensation is hardly challenged, and seen as unbalanced. However, when the same effect is caused by an indirect measure, suddenly the obligation to pay compensation causes a huge unbalance. I shall demonstrate this argument by a fictional example. Let's say that a foreign investor has a mining factory in an area that is found to be important for the protection and preservation of certain species. The host state has concluded a biodiversity treaty, and has an international obligation to protect and preserve the certain species. The state has two options. It can either legally transfer the title of the ownership of the investor's property in order to turn the area into a protected area, or it can enact general regulation that would prevent the investor of using its investment, and turn the area into a protected area. In both cases, the investor would lose all economic benefits of its investment. Also the weight of the legitimate public interest in both cases would be the same. It is hard to argue why the investor would be in the first case entitled to full compensation, and in the second case given no compensation at all. Also, if the state would have the opportunity to escape the duty to pay compensation by going with the second option, it most certainly would. In the investment treaties, the two forms of expropriation, direct and indirect, are treated as the same for the very reason of preventing the states from escaping the obligation to pay compensation, by achieving the same goal through indirect measures.

If it is agreed that balancing the interests, in a case where an investor would lose the economic value of its investment would require some amount of compensation to be paid,

solely the fact that states, when concluding investment treaties, decided that in case of deprivation of the investment the amount of adequate compensation would be appropriate does not create an 'unbalance'. One should note that states made an intentional choice not to provide room for much discretion inside the standard of compensation.[174] This indicates that in the opinion of the states only 'adequate compensation' would be appropriate in case of indirect expropriation.[175]

8.5. Proportionality analysis

8.5.1. Transplantation of the proportionality analysis

As was seen in the case of Tecmed v. Mexico, some investment tribunals have started to transplant the proportionality analysis developed in the practice of the ECHR into to the determination of whether an indirect expropriation has occurred. From the point of view of balancing two divergent interest, the principle of proportionality might sound appealing as the means of solving the problem. Proportionality analysis is often seen to be the suitable instrument for finding the optimal solution when reconciling two conflicting interests. The aim of the principle of proportionality is to ensure that when pursuing a noble public cause such as the protection of the environment, the adverse effect imposed on individual interests is proportionate.[176] In the practice of the ECHR, the principle of proportionality has played a significant role in the context of the deprivation of property and of the control of the use of property. Transplantation of this analysis is, however, highly problematic and requires careful consideration. It shall never be too quickly assumed that principles developed in a particular legal system, municipal or regional, would be automatically applicable on a global basis.[177]

[174] See more on the history of the development of the compensation standard for expropriation under investment treaties: Hailu (2014), p. 11-17
[175] Muchlinski, Ortino & Schreuer (2008), p. 1069
[176] López (2014), p. 60
[177] Byrne (2000), p.118

8.5.2. Placement of the proportionality analysis

The principle of proportionality has traditionally been an unfamiliar concept in the investment treaty sphere.[178] When building his theory of global public interest in the investment law, Kulick presents a profound case for the proportionality analysis and its use in the interpretation and application of investment protection provisions. After taking a comparative look at other legal systems, Kulick identifies two different approaches of the application of the proportionality analysis. In the practice of the U.S., the place of the proportionality analysis is in the stage of assessment whether or not the state has infringed the protected freedom or right.[179] The assessment of rights violations in the practice of the ECJ and the ECHR as well as in the German doctrine on the other hand follows a three-tier analysis. According to the three-tier analysis, the tribunal has to first define the scope of the right in question. Second, the tribunal needs to determine whether the state conduct has infringed the right. And third, it needs to examine whether a justification for the infringement exists i.e. if the infringement was permissible.[180] According to Kulick, the U.S. is still far from wholeheartedly implementing the proportionality analysis partly since it would cause problems fitting into the doctrine of an uniform approach.[181] It does not come as a surprise that Kulick sides with the three-tier approach. Following the three-tier approach, the place of proportionality analysis is in the last tier. Thus, the proportionality analysis serves no purpose in the first two stages. Therefore, when accepting the rationale of the three-tier analysis, proportionality arguments have no room in the stage of determining the scope of protection or whether a state has infringed the protected right. Translating this to the expropriation context would mean that when determining the scope of indirect expropriation the proportionality analysis i.e. the balancing of conflicting interests has no room. The same applies when determining whether or not the state regulatory measure constitutes an indirect expropriation. Only at the stage of determining the lawfulness of the expropriatory measure, the proportionality analysis would be applied. Since siding with the three-tier approach, Kulick argues that in the case of expropriation the right place for the balancing of the interests and for the proportionality analysis would be in the stage of determining whether the expropriation meets the legality criteria, and not in the stage of determining whether a

[178] Nikièma (2012), p. 15
[179] Kulick (2012), p. 195
[180] Kulick (2012), p. 196
[181] Kulick (2012), p. 196

direct or indirect expropriation has occurred. When accepting the rationale of the three-tier analysis, the arguments relating to balancing the conflicting interest of the investor and of the host state are not relevant in the determination of whether a regulatory act of the state constitutes an expropriation. Since the ECHR follows the three-tier analysis, one must be careful when citing the ECHR case law in the investment treaty sphere in order to support the use of the proportionality analysis. If relying on the doctrine that the ECHR follows, the place of the proportionality analysis is in the determination of the lawfulness of the expropriation. Therefore, one should not cite the ECHR case law in order to argue that an indirect expropriation has not occurred due to the fact that the government measure passed the test of proportionality analysis. This is the very mistake the Tecmed tribunal did when endorsing the proportionality analysis. The tribunal referred to the practice of the ECHR, and stated that:

> "the Arbitral Tribunal will consider, *in order to determine if they are to be characterized as expropriatory*, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality."[182]

Interestingly, the tribunal referred to the chapter "C. Whether the interference was justified" of the ruling of the ECHR,[183] and still did not comprehend the idea that the ECHR applies proportionality analysis when determining whether the de facto expropriation was permissible/lawful and not when determining the existence of the de facto expropriation.

It shall also be noted that in the practice of ECHR the amount of compensation paid has been a key factor when deciding whether a measure was proportional and a fair balance found. According to the ECHR:

> "Clearly, compensation terms are material to the assessment whether the contested legislation respects a fair balance between the various interests at stake and, notably, whether it does not impose a disproportionate burden on the applicants"[184]

[182] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 122 (emphasis added)
[183] Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, para 122 and Matos e Silva, Lda., and Others v. Portugal, ECHR 16 Sep 1996, para 92, p. 19
[184] James and Others v The United Kingdom, ECHR 21 Feb 1986, para 54

Therefore, the appropriate adoption of the proportionality analysis would require that first, the proportionality analysis would be executed in the stage of determining the lawfulness of the measure, and second, it would require that the either-or nature of the compensation requirement would be set aside, and the tribunals would be given wider room to decide what would amount to an appropriate compensation. The majority of the expropriation clauses, however, leave little to no room for proportionality considerations. It is notable that the text of the Article 1 of Protocol 1 is much more open to proportionality considerations than the typical expropriation clauses in the investment treaties.[185]

8.5.3. Proportionality analysis and a law making judge

Using the principle of proportionality as the defining test, when drawing the line between normal regulation and regulatory action constituting expropriation, is also problematic considering the adjudicative system created in the international investment law. Applying the principle of proportionality leaves arbitrators with quite a bit of room for discretion. As Kulick notes, one cannot ignore the function of the judge as law making when given the task to review political decisions enshrined in regulations and reconcile conflicting interests. Introducing the proportionality analysis will, therefore, come with the dangers that inhere in a law-making judge. The arbitrator is left with the task to determine how much emphasis on each competing interest shall be given, and at the end to decide which interest shall prevail.[186] It is rightly so criticized that the adjudication system created in the international investment law is not ready to take on such a role.[187] Transporting a principle from the case law of the ECHR that is a body of a specific legal system to an international investment treaty sphere, therefore, raises problems. The ad hoc arbitrators lack the same legitimacy as ECHR judges due to the nature of the international investment law. The international investment law as stated is based on complex network of bilateral investment treaties. Transplanting the considerations of highly subjective elements as the notion of proportionality is more problematic in the setting of an arbitral tribunal composed of private individuals and no appeal mechanism. It is to be concluded that the current state of

[185] Nikièma (2012), p. 16-17
[186] Kulick (2012), p. 171-172
[187] More on the critique relating to the adjudication system developed in the international investment law see: Van Harten, G. (2007)

international investment law, especially regarding indirect expropriation, is not suitable for the transposition of the principle of proportionality.[188]

8.5.4. The police powers doctrine and the proportionality test

One might still suggest that the principle of proportionality might serve as the saviour of the police powers doctrine. The main problem with this approach is the fundamental argument that the police powers exception builds itself on, and that the acceptance of the proportionality requirement might end up working against it. The underlinening argument for the police powers doctrine is that states in the sphere of their police powers can act freely in the public interests *without being obligated to pay compensation* for the negative effects caused by regulative measures. When adding the proportionality requirement into the mix, the new doctrine would state that the states have such right only to the extent that the result of the regulative measure is proportional considering the interests of the negatively affected party. Since regulative measures that lead to a total deprivation of the value of the property without compensation are hardly ever seen proportional, the very idea of the police powers doctrine as an exception to the obligation to pay compensation would diminish. When applying the proportionality test, the option of not paying any compensation is hardly in the picture in case of de facto expropriations.

8.6. Conclusions of the critique

The aim of this chapter was to demonstrate that the sole effects doctrine should prevail since it finds sufficient legal support from the investment treaties. The police powers doctrine, on the other hand, does not have sufficient legal support from the sources of international law, and therefore, should not be applied. The Article 38 of the ICJ Statute expresses the commonly accepted sources of international law. According to the Article 38 of the ICJ:

> 1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

[188] Nikièma (2012), p. 17

a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states ;
b. international custom, as evidence of a general practice accepted as law;
c. the general principles of law recognized by civilized nations ;
d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.
2. This provision shall not prejudice the power of the Court to decide a case ex aequo et bond, if the parties agree thereto.

According to this Article, the three sources of international law are treaties, norms of customary international law, and general principles. As demonstrated in this chapter, the police powers doctrine finds no legal support from the investment treaties. The legal support of customary international law seems to be questionable at the best, and the status of the police powers exception regarding expropriations as a general principle has not been even suggested in practice nor in academic writings. Therefore, one cannot but conclude that the police powers doctrine does not find sufficient legal support from the sources of international law. The sole effects doctrine, on the other hand, has sufficient legal support and shall therefore prevail.

It has also been concluded that the police powers doctrine cannot be sustained by the arguments regarding the need for balancing the conflicting interests nor by endorsing the proportionality test developed in the practice of the ECHR.

9. The next generation of expropriation clauses

A trend among the recent investment treaties is the inclusion of provisions reaffirming the states' right to regulate, and the use of explanatory annexes listing factors that an investment tribunal should consider when determining whether a state measure constitutes an expropriation.[189] The Article 8.9 of the CETA reaffirms the states right to regulate. According to the Article 8.9:

> "1. For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity.
>
> 2. For greater certainty, the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation under this Section."

Regarding indirect expropriations, inclusion of provisions merely reaffirming the state's right to regulate does not really limit the state's potential liability for indirect expropriations. Understanding that expropriation clauses do not prohibit a state to take regulatory action, this provision would seem to have no impact whatsoever. It also does not exclude the obligation of the state to pay compensation in the case when the use of the right to regulate would lead to a substantial deprivation of the investment. This provision is also in line with the sole effects doctrine since as stated the sole effects doctrine does recognize the right of the state to regulate and that not every regulation that causes negative effects on the investment constitutes expropriation. Therefore, the mere reaffirmation of the right to regulate is not sufficient enough to exclude regulatory acts from the scope of indirect expropriation, or to prevent a tribunal form concluding that such regulatory acts could constitute expropriation.[190]

[189] It shall be, however, noted that the number of investment treaties that contain these type of provisions and explanatory annexes remains small. Majority of the investment treaties do not contain such clauses. Nikièma (2012), p. 12

[190] Nikièma (2012), p. 9

The CETA convention also contains an explanatory annex providing a list of factors that shall be considered when determining the existence of indirect expropriation. According to the Annex 8-A of the CETA:

> "The Parties confirm their shared understanding that:
> 1. Expropriation may be direct or indirect:
> (a) direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and
> (b) indirect expropriation *occurs* if a measure or series of measures of a Party *has an effect equivalent to direct expropriation*, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.
> 2. The determination of whether a measure or series of measures of a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that
> takes into consideration, among other factors:
> (a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
> (b) the duration of the measure or series of measures of a Party;
> (c) the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and
> (d) the character of the measure or series of measures, notably their object, context and intent.
> 3. For greater certainty, except in the rare circumstance *when the impact* of a measure or series of measures *is so severe in* light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations."[191]

Rather than endorsing the police powers doctrine, this explanatory clause does indeed recognize the possibility that regulative measures taken in the public purpose could amount to expropriation, and therefore are not excluded from the scope of indirect expropriation or from the obligation to pay compensation. The explanatory clause determines indirect

[191] (emphasis added)

expropriation, by referring to the effect, and endorses the idea that at the end the decisive weight is given to the effect of the measure. The legitimate public purpose and the character of the measure can be seen as factors raising the threshold of the severity of the effect. However, the severity of the depriving effect shall at the end determine the existence of indirect expropriation. Though only time will tell how tribunals will apply these newer treaty clauses in practice.

Explanatory notes, like the CETA Annex 8-A , can be seen as one more indication that a norm excluding regulatory acts from the scope of indirect expropriation clauses does not exists in the customary international law. Form the wording of the explanatory notes one can clearly see that while the character of the government measure shall be taken into account when determining the existence of indirect expropriations, general regulatory measures are not excluded from the scope of indirect expropriations according to the understanding of the states.

Notable is also the fact that while the recent treaties like CETA did not exclude the possibility that regulatory measures could constitute expropriation, they did not modify the obligation to pay adequate compensation in case of indirect expropriation either. For instance CETA in Article 8.12 states that in case of expropriation, direct or indirect, full compensation which is adequate to the fair market value of the investment, shall be paid.

10. Conclusions

To conclude, this thesis has searched an answer to the question of how to determine when regulative measures amount to expropriation. After concluding this doctrinal study, it is evident that the sole effects doctrine should prevail as the appropriate method of examining the existence of indirect expropriation. While the police powers doctrine lacks sufficient legal support, and therefore, cannot be sustained, the sole effects doctrine finds firm legal support from the investment treaties. Even though in the current political climate, emphasising the environmental concerns and endorsing the police powers doctrine would be undeniably more politically legitimate and appealing, one shall not ignore the lack of appropriate legal support of the police powers exception. Even politically tense legal issues shall be resolved by legal norms.

The discussion regarding regulatory expropriation often presents the states as victims and the foreign investors as unjust winners. This, I would say, is a rather neglectful way of presenting the situation. Investment treaties are international treaties concluded between sovereign states. Private investors have no legal power when these treaties are concluded. States, as sovereign subjects of international law, have all the power to conclude, terminate, and amend investment treaties according to their wishes. If a state no longer wishes to protect investors against indirect expropriation caused by regulatory measures, the state is free to make the required legal changes. As the recent trends regarding newer expropriation clauses demonstrate, states have been reluctant to totally exclude the regulatory measures from the scope of indirect expropriations, or to make exceptions to the obligation of paying adequate compensation in case of every indirect taking.

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